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No. 718

# In the Supreme Court of the United States

OCTOBER TERM, 1960

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JAEGER MOTOR CAR COMPANY, ET AL., PETITIONERS

*v.*

COMMISSIONER OF INTERNAL REVENUE

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT*

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## BRIEF FOR THE RESPONDENT IN OPPOSITION

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### OPINIONS BELOW

The opinion of the Tax Court (R. 343-391)[1] is unreported. The opinion of the Court of Appeals (Pet. 15-31) is reported at 284 F.2d 127.

### JURISDICTION

The judgment of the Court of Appeals was entered on November 16, 1960. The petition for a writ of

[1] "R." refers to the separate appendix to the petitioners' brief in the Seventh Circuit.

certiorari was filed on February 11, 1961. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

## QUESTION PRESENTED

Whether the courts below were correct in finding that payments made by the Jaeger Motor Car Company, during the years 1947 through 1951, for improvements to property owned by Anthony Jaeger, its largest stockholder and president, constituted dividend income to Anthony Jaeger.[2]

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[2] The other issue raised by taxpayers (Pet. 3) as to whether the Jaeger Motor Car Company, the corporate lessee, is entitled to an allowance for amortization of leasehold improvements was not answered by the Tax Court because of its holding that the improvements constituted dividend income to Anthony Jaeger, who, in turn, was therefore entitled to the depreciation deductions. Accordingly, the Tax Court did not make any findings bearing on the rate of depreciation which would have been applicable to the Jaeger Motor Car Company if the improvements had been depreciable by the company. In the court of appeals, the Commissioner filed protective appeals requesting that, if the trial court were reversed on the dividend issue, the case be remanded to the trial court for elimination of the depreciation deduction allowed to Anthony Jaeger and for findings bearing on the rate of depreciation applicable to the Jaeger Motor Car Company. Since the appellate court affirmed the Tax Court, it did not reach the issues raised by the Commissioner's protective appeals. Should certiorari be granted and the lower courts reversed, we submit that the present cases should be remanded for consideration of the issues raised by the Commissioner's protective appeal.

## STATUTES INVOLVED

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) [as amended by Sec. 1, Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * *

(e) *Distributions by Corporations.*—Distributions by corporations shall be taxable to the shareholders as provided in section 115.

* * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 115 [as amended by Sec. 166 of the Revenue Act of 1942, c. 619, 56 Stat. 798]. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term "dividend" * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable

year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of Distributions.*—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. * * *

* * * *

(26 U.S.C. 1952 ed., Sec. 115.)

## STATEMENT

These consolidated cases involve deficiencies and additions to tax as determined by the Commissioner. Taxpayers in their petition for certiorari dispute only a portion of these deficiencies; the remainder are now conceded. The facts pertinent to the only real issue raised in taxpayers' petition (see note 2, *supra*, p. 2), as found by the Tax Court (R. 356-361), are as follows:

Anthony Jaeger, the president and largest stockholder (81.2%) of the Jaeger Motor Car Company, a family corporation, at all times during the years in question, was the owner of certain property located on North 27th Street in Milwaukee, Wisconsin.[3] During those years, Anthony Jaeger leased this property to the Jaeger Motor Car Company for a stipulated rental of $500 per month. There was no

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[3] Hereinafter referred to as the North 27th Street property.

written lease. (R. 346, 347, 356.) Anthony Jaeger testified that it was his understanding that he could terminate the lease arrangement at any time on 30 days' notice. (R. 382; Pet. 27; see R. 311, 313.)

In 1946, the Jaeger Motor Car Company requested Anthony Jaeger to improve this property since one building thereon had been damaged as a result of alley repairs by the city and the facilities had become too small to accommodate Jaeger Motor Car Company's rapidly growing business. Accordingly, an alteration and expansion program was initiated by Anthony Jaeger. Bills totaling $16,867.56 were paid by company check and charged on the books of the company to Anthony Jaeger's personal account. At a board of directors meeting on May 6, 1947, Anthony Jaeger suggested that, since the "Company was in a better position to assume the liabilities for * * * [the improvements initiated by him], that said Company take over said liabilities and assume payment for such * * *." An entry was made transferring the charges of $16,867.56 from Anthony Jaeger's personal account to a Jaeger Motor Car Company account called "Leaseholds and Improvements." (R. 357-359.)

On September 18, 1947, Mr. Roblee, the certified public accountant employed by Anthony Jaeger and the Jaeger Motor Car Company, warned Anthony Jaeger by letter of the possibility of the Jaeger Motor Car Company being taxed on its substantial undistributed profits under Section 102 of the 1939 Code.[4]

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[4] The company's earned surplus, as reported on its income

(R. 358.) Mr. Roblee wrote as follows (R. 358-359):

> To avoid this tax under Section 102, you must show conclusively that the reason 70% [of current earnings] was not paid out was due to the fact that you needed the money in your business, either to make needed improvements or for expansion purposes. . .
>
> Some manufacturing plants can easily do this if they are putting up large additions to their plant and are expanding their businesses and need the cash. But I do not think that you have much of a chance to prove that you need these excess earnings for your business for the reason that you can take care of all of your commitments fairly well out of your current income.

Mr. Roblee consequently suggested in his letter that in order to avoid this tax the Jaeger Motor Car Company should immediately pay a cash dividend of not less than $25,000. (R. 359.)

On November 30, 1947, Harry Petrie, Anthony Jaeger's son-in-law and an attorney, requested the bookkeeper of the Jaeger Motor Car Company to make out dividend checks in the amount of $25,000. The checks were prepared and an appropriate entry

---

tax returns, was as follows (R. 358):

| | | |
|---|---|---|
| December 31, | 1945 | $ 44,341.53 |
| " | " 1946 | 108,017.47 |
| " | " 1947 | 198,758.19 |
| " | " 1948 | 326,123.91 |
| " | " 1949 | 394,283.99 |
| " | " 1950 | 514,576.08 |
| " | " 1951 | 555,491.35 |

was recorded on the company's books. (R. 359.) Thereafter, on December 8, 1947, the directors of Jaeger Motor Car Company met to consider formally the question of declaring a cash dividend. The minutes of this meeting (R. 359-361) reveal that Anthony Jaeger advised the directors at that time of an approximately $100,000 building expansion program to which he had committed the Jaeger Motor Car Company in his capacity as president. All directors agreed that such improvements were essential, but that, in view of this expenditure, the Jaeger Motor Car Company did not have sufficient assets to pay a cash dividend to the stockholders. (R. 361.) During the remainder of 1947 and throughout 1948 to 1951, the Jaeger Motor Car Company paid for the improvements to the North 27th Street property owned by Anthony Jaeger the following stipulated amounts (R. 103, 361):

| | |
|---|---|
| 1947 | $26,131.92 |
| 1948 | 70,977.42 |
| 1949 | 43,976.29 |
| 1950 | 11,486.76 |
| 1951 | 2,095.00 |

The Tax Court concluded that these improvements paid by the Jaeger Motor Car Company constituted dividend income to Anthony Jaeger in the years when made.[5] (R. 361.) The Court of Appeals affirmed. (Pet. 26-29.)

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[5] Anna Jaeger, the wife of Anthony Jaeger, is individually involved only by virtue of having filed joint returns with Anthony Jaeger in the years 1948 through 1953. (R. 346; see Pet. 16.)

## ARGUMENT

The holding of both courts below that the improvements constituted dividend income to Anthony Jaeger is based upon the particular facts of this case; contrary to taxpayers' assertions, there is no conflict with the decisions of this Court or of any of the circuit courts; and the issue was resolved correctly by the courts below. There is therefore no warrant for further review by this Court.

1. Taxpayers' assertion (Pet. 8-14) that the decision below is in conflict with *M. E. Blatt Co.* v. *United States*, 305 U.S. 267, and *Commissioner* v. *Cunningham*, 258 F. 2d 231 (C.A. 9), is based on the theory that, as provided in Section 22(b)(11) of the Internal Revenue Code of 1939 and the Treasury Regulations promulgated thereunder (Pet. 3-4), improvements to leased property do not constitute income to the lessor unless they represent rent. Although this is the rule with respect to improvements to a taxpayer's property derived from a lessor-lessee relationship, the rule does not apply to improvements derived from some other relationship. In the present case the lease was terminable on 30 days' notice, and thus, as the lower courts found (R. 382; see Pet. 27), "the stockholder had within his power the right to regain possession of his property with the attached improvements made by the corporation at virtually any time he pleased." The Tax Court also observed (R. 383) that "no lessee would make $150,000 worth of leasehold improvements without being protected by a long-term lease * * *." Finally, it was obvious that Mr.

Jaeger as the president and dominant stockholder of the lessee was in a position to negotiate for both sides. The lower courts therefore had ample basis for concluding that the improvements to Anthony Jaeger's property were derived from the stockholder-corporation relationship between Mr. Jaeger and the Jaeger Motor Car Company, and not from any lessor-lessee relationship between the two. (See R. 381-383; Pet. 26-29.) There is thus no conflict with the *M. E. Blatt Co.* and *Cunningham* decisions, both of which involved long-term leases and improvements obviously derived from a lessor-lessee relationship.

2. The improvements to Mr. Jaeger's property, derived from the stockholder-corporation relationship, constituted dividend income to Mr. Jaeger. The payments by the corporation out of its earnings and profits to improve the property conferred an economic benefit on Mr. Jaeger; economic benefit is a standard consistently used by the courts in determining whether a dividend distribution has been made. See *Sachs* v. *Commissioner*, 277 F. 2d 879 (C.A. 8th), certiorari denied, 364 U.S. 833; *Hash* v. *Commissioner*, 273 F. 2d 248 (C.A. 4th); *58th St. Plaza Theatre* v. *Commissioner*, 195 F. 2d 724 (C.A. 2d), certiorari denied, 344 U.S. 820.

Moreover, the corporate payments satisfied personal debts and liabilities of Mr. Jaeger; such payments have been held to constitute dividend income to a stockholder. See *Sachs* v. *Commissioner*, *supra*; *American Properties, Inc.* v. *Commissioner*, 262 F. 2d 150 (C.A. 9th); *Greenspon* v. *Commissioner*, 229 F. 2d 947 (C.A. 8th); *Byers* v. *Commissioner*, 199 F. 2d

273 (C.A. 8th), certiorari denied, 345 U.S. 907; *Wall* v. *United States*, 164 F. 2d 462 (C.A. 4th); *Paramount-Richards Theatres* v. *Commissioner*, 153 F. 2d 602 (C.A. 5th). This fact is easily established by the record. The building program was for capital improvements to Anthony Jaeger's property, a type of expenditure which Mr. Jaeger had always personally assumed. (R. 357.) Mr. Jaeger initiated the program at the request of the company. (R. 358.) The bills submitted as the work progressed on the improvements were charged on the company's books to Mr. Jaeger's personal account. (R. 357.) When it appeared that the cost would substantially exceed the original estimate, Mr. Jaeger suggested at a board of director's meeting on May 6, 1947, that the company "take over said liabilities and assume payment for such" because it was in a better position to do so. (R. 358.) Finally, a number of months later, the building expenses charged to Mr. Jaeger's personal account were transferred to the company. (R. 359.) Subsequently, other expenditures attributable to Mr. Jaeger were undertaken by the company. (See R. 359-361.) Thus, the liabilities for the building improvements were Mr. Jaeger's personal liabilities from the outset, were taken over and assumed by the company later at Mr. Jaeger's request because he was not in a good position to pay them (R. 358). The assumption of these obligations constituted dividend income to Mr. Jaeger.

The fact that a dividend was not formally declared or was not *pro rata* among the shareholders is of no importance in determining the true nature of the corporate payment to Mr. Jaeger. See *Sachs* v. *Commissioner*, *supra*, and cases cited therein. When a

corporation confers a benefit on a stockholder out of earnings and profits, regardless of motive or manner of payment, it is a "dividend" within the meaning of Section 115(a) of the 1939 Code, *supra*, pp. 3-4, which is taxable to the stockholder under Sections 22(a) and (e) of the 1939 Code, *supra*, p. 3.

## CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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